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Property and Contract: Toward a Clearer Understanding of the Hague Convention on the Law Applicable to Certain Rights in respect of Securities*

James Steven Rogers**

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The basic principal of the Hague Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary is that where securities are held through an intermediary, the law that governs a transaction effected by entries made on the books of a securities intermediary is determined solely by the relationship between the investor and the intermediary. The Hague Convention rejects any approach under which the law governing a transaction in indirectly held securities is determined by reference to connecting factors affecting the underlying securities. In the terminology used during much of the discussion leading to the Convention, the basic rule is the "Place of the Relevant Intermediary Approach" or "PRIMA" rather than the "look through" approach. Ultimately, the Convention adopted the principal that one could not really give coherent meaning to the notion of a "place" of the relevant intermediary. Thus the Convention adopts the principal that the law governing a transaction effected on the books of an intermediary is, in general, determined by the law selected by the intermediary and customer. This paper does not deal with the detailed rules of the Convention concerning the determination of the law by agreement, the limitations on such agreement, or the fall-back rules. Rather, the paper deals at a more general level with the basic approach taken in the Convention. For convenience, the term used in American law--the "securities intermediary's jurisdiction"--will be used as a shorthand for the law determined under the detailed rules of the Convention.

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One of the issues that prompted considerable discussion in the Hague Convention process was whether it was possible to have a rule under which a single state's law would apply to all stages of a securities transaction. Consider, for example, the scenario described in the introductory portion of the Explanatory Report of the Convention: Shares of Illinois, Inc, a corporation organized under the laws of the state of Illinois in the United States, are held through an account at Depository Trust Company in New York. Part of the block of Illinois Inc. shares are shown on DTC's books as being held for the account of New York Bank. New York Bank's records in turn show that it holds part of those shares for the account of European ICSD, organized, let us say, under Belgian law. European ICSD's books show that part of its position is held for French Bank, located in Paris. French Bank's books show that part of its position is held for the account of Australian Investor. Under the rules of the Convention, different state's laws apply at different stages of the holding chain. Thus, Australian Investor's position, which it holds through an account with French Bank, is governed by the law of its securities intermediary's jurisdiction, presumably France. French Bank's position, which it holds through an account with European ICSD, is governed by the law of its securities intermediary's jurisdiction, presumably Belgium. European ICSD's position, which it holds through an account with New York Bank, is governed by the law of its securities intermediary's jurisdiction, presumably New York. New York Bank's position, which it holds through an account with DTC, is governed by the law of its securities intermediary's jurisdiction, presumably New York. DTC's position, which is held directly of Illinois Inc., is governed by the law of Illinois.¹

By contrast to the approach taken in the Convention, the traditional "look through" approach would say that all questions concerning the same underlying asset--the shares of Illinois Inc--are governed by a single law, the law proper to that asset. Thus, all questions in the above described chain would be governed by Illinois law.

¹ To simplify somewhat, it will be assumed herein that Illinois Inc.'s transfer agent is also located in Illinois.

Early in the discussions that led to the Hague Convention, it was generally agreed that the "look through" approach was unworkable. The reasons for that broad consensus need not be explored in detail here. Rather, I wish to call attention to a somewhat more subtle point that has more significant consequences. How do we know the information about the chain of holdings described above? The answer is that the facts are simply stipulated. That stipulation is a significant part of the deeper problem. In fact, the ultimate investor--Australian Investor in the example above--would have no way of knowing or discovering the facts that are assumed in our hypothetical. Australian Investor knows only (1) that he holds shares of Illinois Inc. and (2) that those shares are held through an account with French Bank. Australian Investor has no way of knowing any of the other facts about the holding chain. Indeed, if Australian Investor asked the person with who he deals at French Bank how French Bank holds the shares, he would probably be met with a puzzled silence. How the firm conducts its back office operations is simply not a matter within the usual experience or information of front office personnel of a securities firm.²

Now let us shift attention from the "static" analysis described above to a "dynamic" analysis of a securities transaction. Let us consider a version of what came to be known in the Hague Convention drafting process as "the page 37 problem."³ To take a fairly simple scenario illustrating the issue, suppose that Seller, located in Atlantis,⁴

² This point is discussed more extensively in James Steven Rogers, "Of Normalcy and Anomaly: Thoughts on Choice of Law for the Indirect Holding System," 13 BUTTERWORTH'S J. INT'L BANKING & FIN L. 47-51 (1998).

³ The moniker "page 37 problem" comes from the fact that the issue was prompted by discussion of an example that appeared on page 37 of Prel. Doc. No. 1 on The Law Applicable to Dispositions of Securities Held Through Indirect Holding Systems (Nov. 2000).

⁴ For simplicity, this paper uses the colloquial expression that an intermediary is "located" in a given jurisdiction, and that the law governing a transaction implemented by entries on its books would be the law of the jurisdiction where the intermediary is "located." That is, of course, an over-simplification, since one of the major problem that the Convention addresses is how to select a governing law given that it may be impossible to say with any certainty where a given intermediary is "located." For purposes of the matters discussed in this paper, however, it will be sufficient to leave consideration of those issues aside

holds shares of Issuer through an account with Atlantis Firm, also located in Atlantis. Seller sells the shares to Buyer, located in Batavia. Buyer holds through an account with Batavian Firm, located in Batavia. The transaction between Atlantis Firm and Batavian Firm is settled by entries on the books of Securities Depository, located in Ruritania. Under the Hague Convention, the relationship between Seller and Atlantis Firm is governed by the securities intermediary's jurisdiction's law, presumably that of Atlantis. The relationship between Atlantis Firm and Securities Depository, and the relationship between Batavian Firm and Securities Depository, is governed by the securities intermediary's jurisdiction's law, presumably that of Ruritania. The relationship between Batavian Firm and Buyer is governed by the securities intermediary's jurisdiction's law, presumably that of Batavia. The so-called "page 37 problem" can be described as follows: "We seem to have a simple transaction between Buyer and Seller, albeit effected through their firms and the clearing agency, but why can't a single body of law describe the transaction? Why complicate matters by dividing the transaction up into various subcomponents and then saying that a different body of law might apply to each subcomponent?"

The first thing to note about the problem is that it is not really unique to securities transactions. Imagine a transaction in which a tractor is sold by Manufacturer, located in Atlantis, and ultimately is purchased by Buyer, located in Batavia. Suppose that the path taken by the tractor is that it is sold from Manufacturer in Atlantis to Exporter in Atlantis. Exporter sells it to Global Trading Company, in Ruritania. Global Trading Company sells it to Importer, in Batavia. Importer, in Batavia, sells it to Buyer, in Batavia. No one would suppose that a single body of law must govern all aspects of "the transaction" simply because it is the same tractor that passes from Seller to Buyer. Rather, it is clear that what counts as "the transaction" depends not simply on the identity of the item that ultimately passes from Seller to Buyer, but on the nature of the relationships among Seller, Exporter, Global Trading Company, Importer, and Buyer. The simple problem

and instead assume that the case involves simple facts where the place that one might say the intermediary is "located" is the same as the place whose law governs under the more elaborate rules set out in the Convention.

reveals that we need to examine the relationships more carefully before we can give any coherent meaning to the notion of the “same transaction.”

With respect to securities transactions, it is also important to separate what we might roughly term the “contract law” issues from the “property law” issues.⁵ It is common to think of a securities transaction as a simple sale from Seller to Buyer. One can imagine very simple transactions in which securities are sold directly from Buyer to Seller, in an off-market transaction, in which Buyer and Seller are the only parties involved. Even there, however, it is one thing to talk about the contract of sale between Seller and Buyer. It is another thing to talk about the performance of the contract by the delivery of the securities from Seller to Buyer. In the more significant category of securities transactions effected through the facilities of securities markets, the distinction between contract and performance is even more important. That distinction however, is somewhat obscured by the common language that is used to describe securities transactions, and by the aspects of securities transactions that are the focus of most legal attention.

Suppose that Betty goes to Firm and places an order to purchase 1000 shares of Acme Inc., a publicly traded corporation. Firm carries out the transaction, and Betty will receive a “confirmation” informing her that the trade was “executed” on a certain date at a certain price. If, as is commonly the case, Betty maintains liquid balances in some form with Firm, the amount of her purchase will be deducted from her liquid position to pay for her purchase. The most important thing to Betty is the price of the transaction, and that will be determined by the price at which Firm “executed” the trade. If Betty gets into a fight with Firm, it is likely to be either about the price at which the trade was executed, or the information that Firm may have given her about Acme on the basis of which she made the purchase. For most purposes, including for purposes of virtually all legal

⁵ The qualification “roughly” is needed because in some systems of law, including that of the United States, the term “property law” is somewhat problematic as applied to the analysis of the rights of parties in the indirect securities holding system. For present purposes, however, the important point is the distinction between contract issues and “whatever,” so that no harm will come from using the simple, familiar terms “property” and “contract.”

regulation of the securities markets, it makes perfect sense to focus on the “trade,” in the sense of the transaction that Firm entered into on Betty’s behalf to purchase the securities.

The subject matter of the Hague Convention, however, is the operation of the system through which securities transactions are *settled*, not the system through which trades are *executed*. For those purposes, it is important to specify more precisely what we mean when we say that the trade was executed when Betty’s Firm made the trade on the securities market. All that it means to say that Betty’s Firm executed the trade for her is that Betty’s Firm *entered into a contract* for purchase of the 1000 shares of Acme Inc. The terms of that contract will be set by the practices and rules of the securities market or exchange through which the contract was made. Among those terms will be provisions concerning how and when the contract is to be performed by the actual delivery of securities and payment of the purchase price. Actually, there are three aspects to what we might very loosely term “the transaction.” First, there is the contract for purchase and sale of the securities. Second, there is the process by which one side of that contract is performed by payment of the purchase price. Third, there is the process by which the other side of that contract is performed by delivery of the securities. The Hague Convention deals only with the law governing the third aspect—the process by which the *securities* side of the contract is *performed*.

Separating the contract issues from the performance issues is quite important in understanding the Hague Convention, but the separation is not really unique to securities transactions. Again, let us consider an analogy from the setting of tangible goods. Consider a transaction involving a contract for sale of a quantity of coal from Seller, located in Atlantis, to Buyer, located in Batavia. Let us suppose that Buyer happens to be in Atlantis, sees that Seller has coal for sale, likes the price, and enters into a contract, signed at Seller’s place of business in Atlantis, to buy a certain quantity of coal, of a specified grade, for a set price. Assume further that the contract calls for the Seller to deliver the coal to the Buyer’s place of Business in Batavia one month after the contract is signed.

Before the time for performance, Seller learns that there is another supplier of coal, X, who has coal of same grade available for wholesale sale at a favorable price, and that coal is located in Batavia. To save shipping expense, Seller buys from X, directing X to deliver to Buyer. X does so. Unless the contract between Seller and Buyer required Seller to deliver “the coal that B saw at Seller’s plant in Atlantis,” Seller can satisfy its obligations under the contract by causing Buyer to receive delivery of coal of the specified grade. It doesn’t matter—so far as Seller’s contractual obligations go—how Seller causes that to occur

But, issues of property law may depend on how Seller attempted to perform its contract. Nothing can change the fact that the coal Seller causes to be delivered to Buyer is either (a) the coal that Buyer saw at Seller’s plant in Atlantis, or (b) the coal that Seller bought from X, directing X to deliver to B. Suppose Seller performed by causing X to deliver to Buyer. Suppose further that X did not actually own that coal—X had stolen it from Owner. Owner learns what happened to the coal and brings an action against Buyer. Buyer says “I have no idea what you are talking about; who you are; or who X is. I dealt with Seller, not with you so I don’t have to worry about your claim that X stole coal from you.” But, Buyer is wrong about that. Either Buyer does or does not have the coal that X stole from Owner. That’s a question of physics, not law. The relevant law might, or might not, say that even though Buyer paid good money for the coal and lacked knowledge of Owner’s claim, Buyer gets good title. That’s an issue on which substantive law varies. Under Anglo-American law, a person who comes into possession of stolen goods must give them back to the owner—it makes no difference whether the person paid good value for the stolen goods or had any reason to be suspicious of their origin. By contrast, under many Civil Law systems, Buyer would take free from Owner’s claim, provided that Buyer paid value and lacked notice of the theft.

So, we may well have a conflict of laws question that must be answered before we can determine whether Owner can or cannot recover the stolen coal from Buyer. It is important to note that the resolution of that conflict of laws question is *not* going to be determined by fact that the sales contract was the contract between Seller and Buyer. One conflict of laws question is what law governs the contract between Seller and Buyer. But, that question is irrelevant to the conflicts issue presented by Owner’s assertion of a

property interest in the coal in Buyer's hands. Rather the conflict of laws question is likely to be determined by the situs of the coal, probably at time of delivery; meaning Buyer's rights are probably determined by Batavian law. Note, in particular, that the law of Atlantis, the place of business of the Seller in the sales contract, has nothing to do with the issue. The relevant conflict of laws question is whether issue is governed by Batavian law or some other law. For example, if X stole the coal from Owner in Carolia, then there might be a dispute about whether the property question is governed by the law of Batavia or by the law of Carolia.

To be sure, contract law issues arising out of the contract for sale between Seller and Buyer may become relevant again after the property issues have been determined. If, under whatever law is determined to govern Owner's claim against Buyer, it is determined that Buyer got good title, free from Owner's claim, then Seller will have satisfied its obligations under the contract. On the other hand, if it is determined that Buyer does not take free from Owner's claim, then Buyer will presumably have a right to pursue Seller for breach of the sales contract. That will be a question of the rights and obligations of Buyer and Seller among themselves, and thus any conflict of laws issues involved will appropriately be resolved by reference to connecting factors arising out of the relationship between Buyer and Seller.

Now let us return to the setting of securities transactions, in which Seller in Atlantis enters into a contract for sale of certain securities to Buyer in Batavia. For the moment, let us assume that it makes sense to talk about a contract for sale of securities between Seller and Buyer. Even so, the contract law issues, and the issues of conflicts of law that might arise preliminary to resolution of the contract law issues, have nothing to do with the property law issues that might arise if there is some question about the interest that Buyer receives. So too, if there are conflict of laws questions on the property side, the resolution of those issues will have nothing to do with the contract between Seller and Buyer. To see the point, suppose that Seller in Atlantis enters into a contract for sale of designated securities to Buyer in Batavia. Suppose that, for whatever reason, Seller performs by having X deliver a certificate for the appropriate securities to Buyer. Suppose further that it turns out that X stole that certificate from Owner. Owner discovers the facts and brings an action against Buyer.

The scenario is essentially the same as the coal case considered above. The fact that securities certificate was delivered to Buyer in performance of a sales contract between Seller and Buyer is pretty much irrelevant to resolution of the property law issue. If Owner can show that the securities certificate delivered to Buyer was the same certificate that was stolen by X from Owner, then Owner presumably can make out a prima facie case. Then we must decide whether, under the appropriate adverse claim rules, Buyer takes free from or subject to Owner's claim. That may, in turn, pose a conflict of law issue if the rules of the various jurisdictions are different on the question of whether, or in what circumstances, a buyer is protected against adverse claims. Note too that one fact that is completely irrelevant to that conflict of law question is the question of what law governs the sales contract between Seller and Buyer. The issue is whether Owner—not Seller—can succeed in its action against buyer once Owner shows that Buyer has the same certificate that X stole from Owner. Suppose that Owner is located in Carolia, and that X stole the certificate from Owner in Carolia, and that X delivered the certificate to Buyer in Batavia. The jurisdictions whose law might determine whether Buyer takes free from Owner's claim are Carolia (the location of the Owner and the theft), Batavia (the location where the certificate was delivered to the buyer), and the jurisdiction where the issuer of the securities was organized. One jurisdiction that we can rule out is Atlantis. The fact that the problem started with a contract for sale of securities from Seller in Atlantis to Buyer in Batavia has nothing to do with the determination of the conflict of laws question about whether Buyer takes free from or subject to the claim of Owner. As in the coal case considered above, if Buyer loses to owner, then Buyer presumably has a breach of contract claim against Seller, and we may have a conflict of laws question in connection with that contract issue, but that has nothing to do with the question whether Buyer took free from or subject to owner's claim, nor with any conflict of laws questions that may arise in connection with that property law issue.

Now let us return to the "page 37 problem." Our scenario was that Seller, located in Atlantis, uses Atlantis Firm to enter into a contract for sale of securities to Buyer, located in Batavia, acting through Batavian Firm, and that the contract is performed between Atlantis Firm and Batavian Firm by entries on the books of Securities

Depository, located in Ruritania. The initial puzzlement was why, under the Hague Convention rules, different state's law might apply to different aspects of "the same transaction." In light of the analysis just developed, we can begin to see why that description is inaccurate. The most important point is that the Hague Convention deals only with the property law issues that might arise in connection with performance of a contract for sale of securities, and that those property law issues are not the same as the contract law issues that might arise in connection with the sales contract.

We should also explore a bit more deeply the implicit assumption that it makes sense to talk about "a" contract for sale of securities between Seller and Buyer. In reality, what happens is that Seller calls her securities firm, Atlantis Firm, and directs Atlantis Firm to sell. As it happens, at about the same time, Buyer calls his securities firm, Batavian Firm, and instructs Batavian Firm to buy. Atlantis Firm and Batavian Firm enter into a contract for sale of the securities through the facilities of some securities market or exchange. Each of the firms then confirms to its customer that the trade has been "executed." Note, however, one piece of information that would be completely irrelevant to both Seller and to Buyer, and that would, in fact, never be disclosed to either—the identity of the other. Seller neither knows nor cares who Buyer is, or who Buyer's Firm is. Buyer neither knows, nor cares, who Seller is, or who Seller's Firm is. All that either Seller or Buyer care about is that their firm has confirmed that the transaction has occurred.

Let us, then, consider the contract law analysis a bit more deeply. Specifically, let us consider whether there really is, in any useful sense, "a" contract for sale from Seller to Buyer.

In part, the answer will depend on the roles that Seller's Firm and Buyer's Firm play in the particular transaction. One possibility is that the transaction is actually a "dealer" transaction rather than a "broker" transaction. In that case, Atlantis Firm, acting as principal, buys the securities from Seller. Then, Atlantis Firm might sell the securities to Batavian Firm, where Batavian Firm is also acting as a principal. Then, Batavian Firm, again acting as principal, sells the securities to Buyer. If both Atlantis Firm and Batavian Firm are acting as dealers, that is, as principals, then there simply is no contract between

Seller and Buyer. Rather there are three separate sales contracts: (1) Seller to Atlantis Firm, (2) Atlantis Firm to Batavian Firm, and (3) Batavian Firm to Buyer. In that case, even if we confine our attention to the contract law issues—which as noted above are not the subject of the Hague Convention—the notion that there are separate transactions that might be governed by separate bodies of law is not at all anomalous. Then, when we turn from the contract issues to the property issues that might arise in connection with performance of those contracts, the result that different bodies of law apply to the three entirely distinct transactions is hardly surprising.

Let us suppose that the firms act as brokers in the transaction rather than as dealers, and consider whether that really makes any significant difference in the analysis. When Atlantis Firm and Batavian Firm meet through the facilities of some securities market or exchange, they enter into a contract for sale of securities, with each party acting as agent for an undisclosed principal. They would never reveal the identity of their respective principals, both because that information is entirely irrelevant to the transaction, and because for competitive reasons neither firm is interested in revealing information about the identity of its customers. So, looking only at the contract analysis, we have a situation in which Atlantis Firm (acting as agent for Seller as an undisclosed principal) enters into a contract for sale of securities to Batavian Firm (acting as agent for Buyer as an undisclosed principal). Consider what body of law governs the various relationships. As between Seller and Atlantis Firm, the question is what law governs the rights and duties of a principal and an agent who enters into a transaction on behalf of the principal, doing so as agent for an undisclosed principal. That is a question of the rights and duties as between Seller and Atlantis Firm, albeit rights and duties that arose in connection with a transaction that Atlantis Firm entered into with someone else. But it seems clear that the question of the rights and duties as between Seller and Atlantis Firm would be determined by the law proper to their relationship. In the simple example where both are located in Atlantis, and where the agreement between them is governed by Atlantis law, that would be the law of Atlantis. If one were to say that the law governing the relationship between Seller and Atlantis Firm is determined by the law that might apply to a direct contract between Seller and Buyer, then one would end up with the odd conclusion that the contractual relationship between a securities firm and its customer is

not determined by a single body of law, but varies, transaction by transaction, depending on the identity and location of the ultimate counterparty to the trade. To see how odd that conclusion would be, one need only note that in the ordinary market transaction, the Seller has no idea who the Buyer is. Thus, the suggestion that the law governing the relationship between Seller and seller's securities firm is determined by the law that would apply to a hypothetical direct transaction between Seller and Buyer would produce the peculiar result that the customer would never know what law governs his relationship with his own securities firm.

There is now no need to examine in detail the question of the law that would govern the contractual relationship between Buyer and Batavian Firm. The situation is exactly the same as the analysis of the contractual relationship between Seller and Atlantis Firm. Thus, the relationship between Batavian Firm and Buyer would be governed by the law of Batavia.

Now let us consider what body of law would govern the contract law analysis of the relationship between Atlantis Firm (acting as agent for an undisclosed principal) and Batavian Firm (acting as agent for an undisclosed principal). Once again, it makes no sense to suppose that the law governing this relationship is determined by anything having to do with either Seller or Buyer. To suppose the contrary would again mean that neither Atlantis Firm nor Batavian Firm could determine what law governs the contractual relationship between them, because each is acting as agent for an undisclosed principal. Accordingly, neither securities firm knows the identity of the other's customer. Hence if facts particular to the customers are relevant to the conflict of laws analysis, neither Atlantis Firm nor Batavian Firm could determine what law governs their contractual relationship. Rather, the answer must be that the law governing the contractual relationship between Atlantis Firm and Batavian Firm is determined by facts arising out of the relationship between them. In any transaction effected through the facilities of an organized securities market or exchange, that question will invariably be resolved by the rules and practices of the market or exchange in question. For example, if the contract between Atlantis Firm and Batavian Firm is made through the facilities of a securities exchange in Atlantis, it will undoubtedly be governed by the law of Atlantis. If the contract is made through the facilities of a securities exchange in Batavia, it will

undoubtedly be governed by Batavian law. If the contract between Atlantis Firm and Batavian Firm is made through the facilities of a securities exchange in another country, it will undoubtedly be governed by the law of that country.

Thus, whether the securities firms in question are acting as dealers or as brokers, it is not possible that a single body of law will govern all of the contractual relationships involved in the transaction between Seller, Atlantis Firm, Batavian Firm, and Buyer. Rather, even on the contractual side, the choice of law analysis must proceed in a step by step fashion. It makes no sense to suppose that the conflicts of laws analysis should be determined by the happenstance that the transaction can—from the standpoint of lawyers' hypotheticals, rather than actual cases—be described as a sale from Seller to Buyer.

Thus far we have been considering the conflicts of law analysis that would apply to the contractual relationships among the parties. Now let us turn to the matters that are actually the subject of the Hague Convention—the property law side. The basic points developed in the contractual analysis described above remain significant. In particular, it is important to note the very odd consequences that would follow from the notion that an ordinary international securities market transaction could appropriately be described as one in which a property interest in the securities passes from Seller to Buyer, through the vehicles of Atlantis Firm, Securities Depository, and Batavian Firm. That consequence is as follows: No one would ever know whether he got good title. If the only way of concluding that Buyer got good title is to determine that title passed from Seller, then no buyer would ever know whether or not he got good title. For the reality is that in an ordinary market transaction, no buyer would ever know who the seller is.

Indeed, the problem is worse than one of access to information. We have been supposing that it makes sense to regard the performance stage of a securities contract as a process by which the individual securities that are the subject of the sales contract pass from Seller to Buyer, through the vehicles of the securities firms and settlement system. That is possible, but it is, in fact, relatively unlikely. In modern securities markets, settlement does not generally occur on an individual trade by trade basis. Rather, all of the trades made through the securities firms on a given market or exchange are

commonly reduced to a single net deliver or receive position. Then, settlement occurs on an aggregate basis.

Suppose, for example, that our hypothetical Seller-Buyer trade is made on the Ruritanian Stock Exchange, and that the members of the Ruritanian Stock Exchange settle among themselves on a net basis. That means that at the end of a given day's trading, all of the obligations of the participants are netted to a single deliver or receive position. Once that occurs, it really makes no sense to talk about how settlement of "the Seller to Buyer" trade takes place. There never is any individual movement of securities from Seller to Buyer, nor even from Atlantis Firm to Batavian Firm. Rather, there is simply a movement of securities to or from Atlantis Firm and the clearing system, and a movement of securities to or from Batavian Firm and the clearing system. The simplest way of seeing why it makes no sense to ask how the individual Seller-Buyer trade is settled is to suppose that in the aggregate Atlantis Firm has a net receive position for that day's trades and Batavian Firm has a net deliver position. Thus although Seller is selling through Atlantis Firm, and Buyer is buying through Batavian Firm, there will be no movement of securities from Atlantis Firm to Batavian Firm. Rather, the opposite will occur—securities will move from Batavian Firm to Atlantis Firm. Or, it might happen that the positions of each of our two securities firms with respect to all other members of the settlement system happen to be such that no securities move to or from either firm when the final settlement obligations are determined for that day's trading. If no securities pass from Atlantis Firm to Batavian Firm, a legal analysis that insists that the only way the Seller-Buyer transaction can be described is a passage of a property interest from Seller to Buyer produces the odd consequence that whether Buyer does or does not get good title depends of the fortuity of what other trades happen to be made through the firms that day.

Thus far we have been assuming that our basic hypothetical scenario is one in which Seller in Atlantis sells securities through Atlantis Firm to Buyer in Batavia, acting through Batavian Firm, and that "the transaction" between Atlantis Firm and Batavian Firm occurs through Securities Depository located in Ruritania. Let us think a bit more carefully about the difference between the contract analysis of the sales contract and the property law analysis of the process through which the sales obligations are performed.

One question is what law governs the sales contract between Atlantis Firm (acting as agent for Seller as undisclosed principal) and Batavian Firm (acting as agent for Buyer as undisclosed principal). Another question is what law governs the property law issues that might arise in connection with performance of that sales contract. It's common that the same law will govern both the contract issues and the property issues, but there is no reason that must be the case. Suppose, for example that the contract between Atlantis Firm and Batavian Firm is made on the Ruritanian Stock Exchange, but that the rules of the Ruritanian Stock Exchange provide that settlement either must or might be made on the books of the Erehwon Securities Depository. The rules of the Ruritanian Stock exchange undoubtedly will provide that the contract between Atlantis Firm and Batavian Firm is governed by the law of Ruritania. But, the rules of the Erehwon Securities Depository will undoubtedly provide that the right of participants arising out of movements of securities through the Erehwon Securities Depository are governed by the law of Erehwon. The contract issues and the property issues are simply different. There is no reason to suppose that they must be governed by the same body of law.

Thus far, we have been considering transaction for the sale of securities. Let us now turn to pledge transactions. Suppose, for example, that Borrower, located in Atlantis, wishes to grant a security interest in certain indirectly held securities to Lender, located in Batavia. Before the transaction, Borrower maintains its securities in an account with Atlantis Firm. Lender insists that securities that are collateral for loans made by it be transferred into a special pledge account that it maintains with its intermediary, Batavian Bank. Borrower and Lender sign a loan and security agreement. They also arrange for the securities to be transferred from Borrower's account with Atlantis Firm to Lender's account with Batavian Bank. The transaction between Atlantis Firm and Batavian Bank is settled by debits and credits on the books of Securities Depository, located in Ruritania. How does the fact that we have a pledge rather than a sale change the conflicts of laws analysis?

The main difference is that the pledge transaction is simpler than the sales transaction with respect to the contractual side. As we have seen, in a securities sales transaction, it really doesn't make much sense to talk about "a" contract between Seller and Buyer. Rather, all of the questions that matter deal with the separate contractual

relationships between seller and its securities firm, between the securities firms, and between buyer and its securities firm. By contrast, in an ordinary secured lending transaction, there will be a direct contractual relationship between borrower and lender. Thus, the contractual side of the conflict of laws analysis is likely to be simpler for a pledge than for a sale. But, that difference is only a matter of the contractual relationship. And, as we have seen, the Hague Convention has nothing to do with the contractual relationship.

On the property law side—which is the matter governed by the Hague Convention—there really isn't any significant difference between the sales transaction and the pledge transaction. How the movement of securities in settlement of the pledge transaction is effected is a matter of the rules of the relevant securities depository. It is entirely possible that Securities Depository in our example would treat a movement of securities in settlement of a pledge under the same system as a movement in settlement of a sale or any other transaction. In that case, we might well have scenarios of the sort considered above in which the net changes of position between Atlantis Firm and Batavian Bank bear no relationship to the individual transaction in which Batavian Bank's position is to be credited and Atlantis Bank's position is to be debited. Even if the transaction between Atlantis Firm and Batavian Bank is settled on a gross basis (that is, transaction by transaction) it remains the case that all of the significant questions on the property law side will be answerable only by reference to the individual relationships between customers and their intermediaries.

For example, in our hypothetical transaction, all that Lender in Batavia cares about is that the designated securities show up in the designated pledge account on the books of Batavian Bank. It shouldn't make any difference to Lender whether Borrower caused that to occur by a transaction that started with a debit to Borrower's account at Atlantis Firm, or a debit to another account that Borrower maintains with Carolia Firm, or to an account maintained by an entity somehow related to Borrower that happens to be maintained with Erehwon Firm. What matters to Lender is that the required collateral appears in the specified account at Batavian Bank. From the standpoint of conflict of laws, what matters is that Lender be assured that if Batavian law says that the appearance of the collateral in that account suffices to give Lender a perfected security interest, then

Lender need not worry about the secured transaction law of any of the other jurisdictions that might have somehow been involved in the series of related transactions. Consider, for example, a scenario somewhat like that in the well-known *Maxwell* case.⁶ Borrower tells Lender that it will pledge Acme Inc securities to Lender as collateral for the loan. The Acme securities are transferred from an account maintained in the name of an entity related to, but legally distinct from, Borrower. As it happens, Borrower is acting wrongfully against that related entity in causing the Acme securities to be pledged to Lender. Suppose that those Acme securities happened to have been maintained by the entity related to Borrower in an account with Erehwon Firm in Erehwon. Indeed, suppose that Lender has no idea where those securities came from, but knows only that Borrower somehow caused the securities to end up in the designated pledge account that lender maintains with Batavian Bank. The important thing is that Lender knows what body of law will determine whether it takes its pledge interest free from or subject to the claim of the related entity. International pledge transactions can only be effected in a safe and efficient manner if Lender can know with certainty that this question will be determined under a single, knowable body of law—the law governing the securities account relationship between Lender and its intermediary, Batavian Bank. That is the result of the Hague Convention.

To summarize, the first step in understanding the basic approach of the Hague Convention is to keep separate questions concerning conflicts of law in connection with contracts for sale of securities and questions of conflicts of law in connection with the movement of property interests involved in the performance of contracts for sale. The Hague Convention deals only with the property issues, so there is nothing surprising about the possibility that different bodies of law might apply to property issues and contract issues. As we have seen, that scenario is quite routine even in connection with arrangements for sale of tangible goods. The next step is to move beyond simple but unrealistic hypotheticals to a more realistic analysis of modern international securities

⁶ *Macmillan Inc. v. Bishopsgate Investment Trust*, [1996] 1 WLR 387.

transactions. As we have seen, even on the contract side, it really doesn't make sense to think of a securities transaction effected through securities firms and exchanges as a simple arrangement between seller and buyer. Rather, even on contractual side, the only realistic way of looking at the scenario is to examine the arrangements step by step. Finally, turning to the property issues that are the only subject of the Hague Convention, we see that there is no necessary reason to suppose that property issues will be governed by the same law as contract issues. Whether that is or is not the case will depend on the facts of the scenario, in particular, how the settlement on the securities side takes place. Thus, the step-by-step approach taken in the Hague Convention can be seen not as an anomaly, but as the only realistic way of addressing conflict of laws issues that may arise in connection with the settlement of international securities transactions.